APPENDIX B

Scoring Lease-Purchases and Leases of Capital Assets

Summary of Changes

—Guidance clarifies that for scoring budget authority and calculating minimum lease payments, the net present value of the total obligations will be calculated on the basis of Treasury rates for marketable debt instruments of similar maturity to the lease period.

—Guidance on scoring operating leases is provided.

—Property taxes will be included in the budget authority that is scored up-front but will be excluded for purposes of distinguishing operating leases from capital leases. (Other types of identifiable annual operating expenses, such as utilities and maintenance, will be excluded for both purposes.)

—It will be presumed that options to renew or purchase will be exercised for purposes of calculating the term of the lease and scoring budget authority.

—Minimum lease payments will be based on the full term of the lease, not the first year costs plus termination liability.

—Agencies should consult with OMB in situations where a service contract requires a private contractor to construct or acquire an asset solely or primarily to provide a service to the Federal government or where enhanced use leases are involved.

This appendix provides instructions on scoring lease-purchases and leases of capital assets consistent with the scorekeeping rule developed by the executive and legislative branches in connection with the Budget Enforcement Act of 1990 (BEA), as revised pursuant to the Balanced Budget Act of 1997 (see Appendix A). The scorekeeping rule focuses on leases and lease-purchases specifically authorized by law. However, the scorekeeping requirements apply to all lease-purchase arrangements and capital leases, including those arrangements that agencies may enter into under existing general legal authorities and arrangements that are financed through the Federal Financing Bank.

1. **Scorekeeping rule.**

When an agency is authorized to enter into a lease-purchase contract or capital lease, budget authority will be scored in the year in which the authority is first made available in the amount of the net present value of the Government's total estimated legal obligations over the life of the contract, as described in section 2 (b) below. Outlays for lease-purchases in which the Federal Government assumes substantial risk will be spread across the period during which the contractor constructs, manufactures, or purchases the asset. Outlays for a capital lease or lease-purchase in which the private sector retains substantial risk will be spread across the lease period. The scorekeeping requirements are summarized below.

For operating leases, budget authority is required in the amount necessary to cover the Government's legal obligations, consistent with the requirements of the Antideficiency Act. This will include the estimated total payments expected to arise under the full term of the contract or, if the contract includes a cancellation clause, an amount sufficient to cover the lease payments for the first year plus an amount sufficient to cover the costs associated with cancellation of the contract. (For subsequent years, sufficient budget authority is required to cover the annual lease payment plus any additional cancellation costs.) In a limited number of instances, where funds are self-insuring under existing authority, only the amount of budget authority needed to cover the annual lease payment is required to be scored. OMB will advise agencies if funds should be considered self-insuring for this purpose.

Unless otherwise specified by law, budget authority is available for liquidating obligations (i.e., outlays) for only five fiscal years after the authority expires. For leases financed by annual or multi-year budget authority, agencies should ensure that the budget authority will remain available for lease payments over the full term of the lease. If this period is expected to be longer than five fiscal years after the authority expires, the appropriations language should include the provision described in section 31.5.

When an agency *modifies* or amends an existing capital lease or lease-purchase contract, any remaining budgetary resources should be used to offset the cost of the new contract and only the difference between the net present value of the remaining term of the original contract and the new contract will be scored. (Both net present values should be calculated using the Treasury cost of financing at the time the contract is amended.) This principle only applies when funds equal to the lease payments or the present value of the lease payments were scored at the time the lease was signed. If funds were not scored up front in this manner, the full cost of the new contract should be scored.

When the lease agreement contains an option to renew that can be exercised without additional legislation, it will be presumed that the option will be exercised for purposes of calculating the term of the lease and scoring budget authority. When the lease agreement contains an option to purchase at less than fair market value (at the time the option is to be exercised), and the option can be exercised without additional legisation, it will be presumed that the option will be exercised for purposes of scoring budget authority.

TRANSACTION	BUDGET AUTHORITY	OUTLAYS
Lease-purchase without substantial private risk	Amount equal to asset cost recorded up front; amount equal to imputed interest costs recorded on an annual basis over lease period.	Amount equal to asset cost scored over the construction period in proportion to the distribution of the contractor's costs; amount equal to imputed interest costs recorded on an annual basis over lease period.
Lease-purchase with substantial private risk	Amount equal to asset cost recorded up front; amount equal to imputed interest costs recorded on an annual basis over the lease period.	Scored over lease period in an amount equal to the annual lease payments.
Capital lease	Amount equal to asset cost recorded up front; amount equal to imputed interest costs recorded on an annual basis over lease period.	Scored over lease period in an amount equal to the annual lease payments.

2. **Budget presentation.**

(a) General.—For the purposes of scorekeeping transactions that involve lease-purchases and capital leases, the costs are separated into the following components:

—*Asset cost;* and

—*Imputed interest cost*

These concepts are defined in section 3 below. Guidance on calculating the appropriate amounts is provided in section 4.

(b) Budget authority.

Amounts.—The up-front budget authority required for both lease-purchases and capital leases equals the present value of the lease payments discounted from the date of the first payment (or the beginning of the lease period, whichever is earlier) using the appropriate Treasury interest rate (see section 3(e)) and excluding obligations for identifiable annual operating expenses that would be paid by the Government as owner, such as utilities, maintenance, and insurance. This is defined as the *asset cost.* For scoring budget authority under the BEA rule, *property taxes* will not be considered to be an operating cost and will be included in the calculation of the up-front budget authority. (See section 3 (c) below for the treatment of property taxes for purposes of distinguishing operating leases from capital leases.).

Additional budget authority in an amount calculated to be equivalent to Treasury's cost of financing (i.e., *the imputed interest cost*) plus any annual operating expenses is required and will be recorded on an annual basis over the lease period.

Type of authority.—As a general rule, when Congress enacts legislation that enables an agency to enter into a lease-purchase or capital lease arrangement for a specific project without further appropriations action, it will be assumed that Congress has provided the budget authority required for the transaction up front. Unless Congress provides the necessary appropriations for such lease-purchases or capital leases in the authorizing legislation, authority to borrow or contract authority will be recorded as follows:

—*Authority to borrow* is recorded up front when the transaction is a lease-purchase without substantial private risk. A portion of the amount appropriated (or collected, if the agency receives offsetting collections) for the annual lease payment will be applied to retire outstanding agency debt.

—*Contract authority* is recorded up front when the transaction is a lease-purchase with substantial private risk or a capital lease. A portion of the amount appropriated (or collected, if the agency receives offsetting collections) for the annual lease payment will be applied to liquidate contract authority.

When an agency enters into a capital lease or lease-purchase arrangement under general authorities available to the agency, it must do so within the limits of the budgetary resources otherwise available to it and the constraints of the scorekeeping requirements; no additional resources are provided.

Timing.—When legislation specifically authorizes a lease-purchase or capital lease, the up-front budget authority (authority to borrow or contract authority, as appropriate) will be recorded when the authority first becomes available for obligation. When the authority stems from general authority available to the agency, obligations are recorded, and sufficient budgetary resources must be available, when the lease agreement is signed.

(c) Outlays.

Lease-purchases without private risk.—Outlays are not equal to the annual lease payments.

Outlays (and agency borrowing) are scored over the period during which the contractor constructs, manufactures, or purchases the asset, in an amount equal to the asset cost. This amount will equal the up-front budget authority. Amounts of the asset cost in excess of the contractor's actual construction or manufacturing costs should be distributed in proportion to the distribution of the construction/manufacturing costs. If the asset already exists, the outlays will be recorded in the year in which the contract is signed.

Outlays equal to the imputed interest costs are reported on an annual basis over the lease period.

Lease-purchases with private risk and capital leases.—Outlays are scored annually equal to the annual lease payments. Over the life of the lease agreement, a portion of the outlays (*asset cost*) will come from obligated balances, and a portion (*imputed interest cost*) will come from new budget authority. The appropriate amounts can be determined from amortization tables developed in accordance with the instructions in section 4.

Outlays attributable to asset costs will be classified as investment-type activities (physical assets), and outlays attributable to imputed interest costs will be classified as non-investment activities (see section 25.4).

(d) Appropriations for annual lease payments.—The annual lease payments under a lease-purchase agreement or capital lease can be divided into two components: asset cost and imputed interest cost. Generally, lease-purchases and capital leases that are specifically authorized in legislation will require annual appropriations in an amount equal to the annual lease payment. Since budget authority equal to the asset cost was already scored up front, the full amount of the annual appropriations will not be scored as new budget authority. This is explained below.

Lease-purchases without private risk.—An amount equal to the asset cost component of the annual lease payment will be treated as redemption of debt. Line 40.47 on the program and financing schedule (portion applied to repay debt) will be used to back out that amount of budget authority and eliminate a double count. When offsetting collections are received in lieu of an appropriation and used to make the annual lease payment, line 68.47 (portion applied to repay debt) will be used.

Lease-purchases with private risk and capital leases.—An amount of annual appropriations equal to the asset cost component of the annual lease payment will be treated as liquidating cash. Line 40.49 on the program and financing schedule (portion applied to liquidate contract authority) will be used to back out that amount of budget authority and eliminate a double count. When offsetting collections are involved, line 68.49 (portion applied to liquidate contract authority) will be used.

(e) Agency debt.—Agency borrowing is scored to finance the outlays for the construction, manufacture, or purchase of an asset in the case of a lease-purchase without private risk. The amount of agency debt that accumulates over this period is equal to the asset cost; this debt is subsequently redeemed over the lease payment period by a portion of the annual lease payments. The appropriate amounts of debt and debt redemption can be determined from the amortization tables developed in accordance with the instructions in section 4, Step 5.

If the account has a balance sheet, the amount of such agency debt should be included as a separate item (and separate from other agency debt) under liabilities and identified as having been incurred to finance lease-purchases. All other accounts with such agency debt should include it in the narrative statement that follows the program and financing schedule (see section 34.6).

3. **Definitions and concepts.**

For the purposes of scoring lease-purchases and capital leases, the following definitions and concepts apply:

(a) Lease-purchase.—A type of lease in which ownership of the asset is transferred to the Government at or shortly after the end of the lease period. Such a lease may or may not contain a bargain-price purchase option.

(b) Capital lease.—Any lease other than a lease-purchase that does not meet the criteria of an operating lease.

(c) Operating lease.—An operating lease must meet all the criteria listed below. If the criteria are not met, the lease will be considered to be a capital lease or a lease-purchase, as appropriate.

—Ownership of the asset remains with the lessor during the term of the lease and is not transferred to the Government at or shortly after the end of the lease period.

—The lease does not contain a bargain-price purchase option.

—The lease term does not exceed 75 percent of the estimated economic lifetime of the asset.

—The present value of the minimum lease payments over the life of the lease does not exceed 90 percent of the fair market value of the asset at the inception of the lease.

—The asset is a general purpose asset rather than being for a special purpose of the Government and is not built to unique specification of the Government as lessee.

—There is a private sector market for the asset.

The following guidelines relate to calculating the term of the lease and the value of the minimum lease payments and will be used to distinguish between capital and operating leases:

Projects on Government land.—If the project is constructed or located on Government land, it will be presumed to be for a special purpose of the Government.

Renewal and purchase options.—If the lease agreement contains an option to renew that can be exercised without additional legislation, it will be presumed that the option will be exercised. If the lease agreement contains an option to purchase at less than fair market value (at the time the option is to be exercised), and the option can be exercised without additional legislation, it will be presumed that the option will be exercised.

Cancellation clauses.—It will be presumed that the lease will run for the full term of the contract and the minimum lease payments will be calculated on the basis of the lease payments that will be made over the full term of the lease (including options to renew).

Property taxes.—Property taxes, along with other operating expenses, *will be excluded* from the lease payments for purposes of comparing the present value of the minimum lease payments with the fair market value of the asset. (Note.—Property taxes will be included in the calculation of the net present value of the lease payments for purposes of scoring budget authority under the BEA. See section 2 (b) above.)

Interest rates.—The present value of the minimum lease payments will be calculated on the basis of Treasury rates for marketable debt instruments of similar maturity to the lease period.

Multi-year service contracts (e.g., grounds maintenance) and multi-year purchase contracts for expendable commodities (e.g., aspirin) will be considered to be operating leases. Agencies should consult with OMB in cases where a service contract requires a private contractor to construct or acquire a capital asset solely or primarily to provide the service to the government and in cases where enhanced use leases are involved.

(d) Risk.—Lease-purchase agreements are scored as with or without substantial private risk depending on the level of private-sector risk. Risk is defined in terms of how governmental in nature the project is. That is, if the project is less governmental in nature, the private sector risk is considered to be higher. The following types of illustrative criteria indicate ways in which the project is less governmental:

—There is no provision of Government financing and no explicit Government guarantee of third-party financing.

—Risks incident to ownership of the asset (e.g., financial responsibility for destruction or loss of the asset) remain with the lessor unless the Government was at fault for such losses.

—The asset is a general purpose asset rather than being for a special purpose of the Government and is not built to unique specification of the Government as lessee.

—There is a private-sector market for the asset.
—The project is not constructed on Government land.

(e) Imputed interest costs.—These are financing costs that Treasury would have incurred if it had issued debt equal to the total project cost. The difference between the total estimated legal obligations (excluding obligations for annual operating expenses) and their estimated net present value represents imputed interest costs. Imputed interest costs will be calculated at Treasury rates for marketable debt instruments of similar maturity to the lease period on the date the contract is signed. These costs will be considered mandatory under the BEA.

(f) Differential cost of financing.—The differential cost of financing equals the total annual interest payments on any debt issued less the interest payments that would occur at the Treasury rate, i.e., less the imputed interest costs.

(g) Asset cost.—The asset cost is the present value of the agency's lease payments discounted from the date of the first payment (or the beginning of the lease period, whichever is earlier) using the Treasury interest rate defined under the preceding definition of imputed interest costs and excluding obligations for identifiable annual operating expenses as described in section 2(b). This is the same as the total construction or acquisition costs, plus property taxes and any interest above Treasury's cost of financing (i.e., the *differential cost of financing*).

4. **Guidance on calculations.**

A schedule of lease payments or an amortization schedule is required to calculate budget authority, outlays, and debt. Illustrative amortization schedules and PC spreadsheets for the amortization schedules (in Lotus 1-2-3 format), are available from OMB's Budget Review and Concepts Division (telephone (202) 395–6149.) The correct Treasury rate to use for discounting to present value and for calculating imputed interest costs will be based on the economic assumptions in the budget. Revised Treasury interest rates will be released whenever economic assumptions for the budget are updated. The term selected for the Treasury rate should be comparable to the term of the lease or lease-purchase. The year to which the interest rate is attributed should be the year the obligation for the lease or lease-purchase is incurred.

Step 1 Calculate up-front BA:

Lease-purchase without substantial private risk; lease-purchase with substantial private risk; and capital lease: To determine up-front BA (i.e., asset cost), calculate the present value of the lease payments, discounting from the date of the first payment or the beginning of the lease period, whichever is earlier using the appropriate Treasury interest rate as the discount factor and excluding obligations for identifiable annual operating expenses as described in section 2(b). This BA is scored when the authority to enter into a contract for the lease-purchase or lease of a capital asset first becomes available for obligation.

Step 2 Calculate outlays over the period during which the contractor constructs, manufactures, or purchases the asset:

Lease-purchase without substantial private risk: Score outlays in proportion to the distribution of the contractor's costs. For example, assume a contractor's costs on a $50 million project are estimated to be $7.5 million the first year, $27.5 million the second year, and $15 million the third year. The analyst should apply spendout rates of 15 percent, 55 percent, and 30 percent to the BA calculated in Step 1 for the first, second, and third years, respectively. Total outlays at the end of the construction, manufacture, or purchase period should equal the BA calculated in Step 1. (Note that total outlays will exceed the contractor's costs.)

Lease-purchase with substantial private risk and capital lease: Outlays are not scored during this period. Refer to Step 4 for outlay scoring.

Step 3 Calculate BA for the lease payment period:

Lease-purchase without substantial private risk; lease-purchase with substantial private risk; and capital lease: Annual BA will equal the imputed interest costs calculated using the same Treasury interest rate used to discount the lease payments in Step 1. The interest rate should be applied to debt that is initially equal to the up-front BA calculated in Step 1 and that is then amortized over the lease period in accordance with Step 5. The interest portion of each periodic payment is the imputed interest cost.

Step 4 Calculate outlays over the lease payment period:

Lease-purchase without substantial private risk: Annual outlays are equal to the annual BA (i.e., the imputed interest costs).

Lease-purchase with substantial private risk and capital lease: Annual outlays are equal to the lease payments.

Step 5 Calculate agency debt (applies only to lease-purchases financed by authority to borrow):

Agency debt accumulates during the period of construction, manufacture, or purchase of the asset. The increase in debt each year equals the amount of outlays calculated in Step 2. Agency debt is subsequently redeemed over the lease payment period according to an amortization schedule. The amount of debt redemption each year is equal to the lease payment less the imputed interest cost as defined in Step 3. (Debt redemption is not scored as BA or outlays.) Imputed interest costs are scored as BA and outlays and are also scored as interest on agency debt.

5. **Reporting to OMB and Treasury.**

Budget execution reports and apportionment requests will reflect budget amounts in accordance with these requirements. Amounts (e.g., budget authority and outlays) will be reported to Treasury on the same basis.